with a complete lack of awareness or understanding of the terms of s. 139(1) (e) of the Income Tax Act and the jurisprudence relating thereto.

In conclusion it is submitted that the impact of the case will not be profound due to inconsistencies to which reference has been made above. What is important, however, is that the Appellant's tax liability was determined by patently contradictory findings in circumstances where an appeal would appear to be economically unadvisable. This in itself deserves comment.

—J. P. PEACOCK*

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ESTATE PLANNING—"FREEZING"—LIABILITY TO TAX—THE MEANING OF "COMPETENT TO DISPOSE" IN ESTATE TAX ACT[1]

Estate Planners received an unpleasant surprise in 1966 in the form of the decision of the Tax Appeal Board in the case of *ESTATE OF FRANK FREDERIC BARBER* v. *MINISTER OF NATIONAL REVENUE*.[2] At first sight the decision appeared to sweep away the advantages of a holding or investment company, capitalized so as to "freeze" the value of an estate for estate tax purposes. Although further consideration suggests that the effect of the decision will not be as far reaching as had at first appeared, it is nevertheless a decision which will have to be taken account of when drafting the "capital" clauses in the incorporating documents of a company which is to be used for estate tax purposes.

In its simplest form, a company incorporated for this purpose usually has a capital consisting of:

(i) voting preferred shares entitled to a fixed non-cumulative dividend, the holders of which have no right to participate in the assets of the company beyond the paid-up par value of their shares, and

(ii) a limited number of common shares, comprising the equity in the Company, but subject to the controlling vote of the preferred shares.

The person wishing to "freeze" the value of his estate will transfer to the company, say $50,000.00 worth of securities, in return for $50,000.00 worth of the preferred shares. Members of his family or others whom he may wish to benefit subscribe for the common shares. If at the time of the Testator's death the value of the securities has grown to $150,000.00, the value of his interest in the company, for estate tax purposes, will still be $50,000.00 (or so it was hoped) and the increase in value will belong to the holders of the common shares.

Margot Investments Limited (the company incorporated by Mr. Barber) was capitalized in a slightly different manner. There were Class A and Class B shares each having equal votes, but the Class A shares carried the right to a fixed cumulative dividend of five percent

1 1958 S.C. c. 29 s. 3(1)d.
2 41 Tax A.B.C. 27; 66 D.T.C., 315.

per annum, and upon dissolution or winding-up of the Company, the holders of the Class A shares were to be entitled to all the assets of the Company remaining after the rights of the Class B shareholders had been satisfied. The Class B shares carried the right to the net profits of the Company, "declared as dividends," after payment of the preferential dividend owing to the Class A shareholders, and upon a dissolution or winding-up of the Company the Class B shareholders were entitled to receive the par value of their shares but no more. It was specifically provided that no dividend would be declared or paid in respect of Class B shares until payment in full had been made of all dividends due to the holders of Class A shares.

At the time of Mr. Barber's death, he was the beneficial owner of 4,500 Class B shares having a total par value of $45,000.00, and Mrs. Barber held the only issued Class A share. The Executors of the estate, when compiling an inventory, valued the Class B shares at their fixed par value. The Minister contended that the surplus in the investment company which existed at the time of the deceased's death should be taken into account when valuing the Class B shares since it was "property of which the deceased was, immediately prior to his death, competent to dispose." Mr. R. S. W. Fordham, Q.C., delivering the decision of the Tax Appeal Board, laid particular stress on the words, "competent to dispose" and held that because the deceased had at all times held voting control of the Company he was: [3]

> . . . always at liberty to change, alter, or amend at will, what he had caused to be created in the first instance. The mere fact that the restrictive provisions governing Margot's shares had been recorded in Letters Patent at Ottawa did not render such provisions immutable. *The deceased had remained free and unfettered to proceed as he might choose.* That, in actuality he did not does not alter the fact that he possessed the power to do what he wanted with Margot's assets.
>
> This circumstance is what brought the arrangement within the ambit of Section 3 (1) (a) of the Act, as clearly he possessed competency 'to dispose.' If there had been other shareholders for value, with consequent vested interests such as strangers, for instance, additional factors might have called for consideration, but this was not the factual position.

Taxation statutes being confiscatory in nature should be strictly construed,[4] and on this ground alone the writer feels that the decision unduly extends the meaning of the words, "competent to dispose." Even if Mr. Barber had been able to use his voting control in the manner contemplated by the Board he would still have had to take various formal steps before arriving at a position where he would have been competent to dispose of the assets. As a fact, up to the date of his death, he had not taken such steps and at such date it is suggested that he was not competent to dispose of the surplus in the Company. It is interesting to note that in a decision given in fairly analogous circumstances only four months later the Tax Appeal Board came to a different conclusion, illustrated by the following quotation: [5]

> It is not a recognized practice, in assessing liability to tax, to take for granted that a controlling shareholder may deal with assets of a company as he sees fit, particularly if such action would be contrary to the best interests of the other

3 *Id.*, at 32.
4 *Denn* v. *Diamond* (1825) 4 B & C, 243.
Doe v. *Snaith* (1832) 8 Bing., 152.
Sneezum v. *Marshall* (1841) 7 M & W, 419.
5 Estate of *James Patterson Maher* v. *M.N.R.* 66 D.T.C. 590.

> shareholders. In fact it seems most unlikely that minority shareholders of Maher Shoes Limited would have agreed to Mr. Maher's doing any of the acts mentioned in Section 3 (5) (a).

The underlying proposition in the decision, that a controlling shareholder, holding shares of one class, has an unfettered power to appropriate to himself property or benefits belonging to a shareholder of another class must seriously be questioned, since it ignores completely the statutory and common law protection given to minority shareholders. The Alberta Companies Act[6] provides as follows:[7]

> If at any time the share capital is divided into different classes of shares, the rights attached to any class, unless otherwise provided by the terms of issue of the shares of that class, may be varied by a special resolution confirmed by an order of the court, with the consent in writing of the holders of three-fourths of the issued shares of that class, or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the shares of the class.

Similar protection of class rights is contained in Section 48 of the Act. It is submitted that in this Province at least, a controlling shareholder is not at liberty to proceed in the manner contemplated by the Board. It is implicit in the Board's reasoning that a wife will always do as her husband wishes—a proposition that is at least open to question.

A fact which may help to distinguish the decision in the Barber case from a future case involving a company capitalized as outlined in the second paragraph of this note, may be that there were accumulated earnings in Margot Investments Limited, part of which might legitimately have been declared as dividends to the holder of the Class B shares (i.e. Mr. Barber), notwithstanding the arguments put forward by counsel for the appellants. The point was not specifically dealt with by the Board but it might have been taken into account in deciding the case. This situation would, of course, not arise where the preferred shares are entitled to a fixed non-cumulative dividend.

In the light of the decision in this case it has been suggested that it might be advisable to arrange the shareholding in a company of this nature so as to ensure that the Testator, while retaining voting control, has a beneficial interest in less than seventy-five per cent of the total voting power, thus disposing of the contention that he can at any time pass a special resolution. It has also been suggested that it should be provided in the memorandum that the rights attaching to one class of shares cannot be varied or diminished without the express consent of the holders of that class of shares, and a carefully drafted provision of this nature could extend the protection already given by Sections 78 and 48 of the Alberta Companies Act.

—K. S. Dixon*

6 R.S.A. 1955, c. 53.
7 *Id.*, s. 78(2).
* K. S. Dixon, Q.C., of the Alberta Bar.

COMPANY LAW—ULTRA VIRES—RIGHT OF THIRD PARTY TO RAISE DEFENCE AGAINST COMPANY—

It is trite law that a company may raise as a defence to an action against it in contract that the particular transaction was *ultra vires* the